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RUEHVK/AMCONSUL VLADIVOSTOK 1754
RUEHIN/AIT TAIPEI 4181

UNCLAS SECTION 01 OF 04 SEOUL 001733

SENSITIVE

SIPDIS

E.O. 12958: N/A
TAGS: ECON EFIN EINV ENRG ETRD KS
SUBJECT: SOUTH KOREA ECONOMIC BRIEFING - OCTOBER 2009

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Domestic Economy

¶2. (SBU) IMF: Korea's Per-capita GDP Down in 2009 before Recovering: The International Monetary Fund (IMF) projected that Korea's per-capita GDP will decrease to USD 16,450 this year, due to the weaker won and sluggish corporate investment and private consumption. But with the faster-than-expected economic recovery and the strengthening of the won in recent months, the international organization raised its outlook for the nation's output growth per person to USD 17,547 in 2010, USD 18,988 in 2011, and USD 20,549 in ¶2012. It surpassed USD 20,000 for the first time in history in 2007 at USD 21,653, but fell to USD 19,136 last year as the value of the won fell precipitously. Initially, the IMF forecast that it would take more than five years for Korea to achieve USD 20,000 per-capita GDP.

¶3. (SBU) Trade Surplus Continues to Grow in September: The Korea Customs Service (KCS) revealed that exports shrank by only 7.8 percent from a year earlier to USD 34.5 billion in September. It is the first single-digit percentage drop since October 2008.

September imports fell 24.6 percent to USD 29.8 billion, marking the smallest decline this year. As a result, the goods trade surplus stood at USD 4.7 billion in September compared with USD 1.67 billion in August. On a month-on-month basis, exports and imports grew 19.1 percent and 9.3 percent from August, respectively, affected by expectations of economic recovery.

¶4. (SBU) Number of Self-Employed Fall by Most in 6 Years: The number of small business owners in September fell at the fastest rate in more than six years, as consumers became increasingly reluctant to spend. According to a National Statistical Office (NSO) report, the number of small business owners dropped by 324,000, or 5.4 percent, to 5.74 million in September from a year before, the steepest fall since April 2003, when a credit card bubble burst. The number has been declining for 13 consecutive months since September 2008, when the collapse of Lehman Brothers triggered the global economic crisis. The self-employed accounted for 33.6 percent of Korea's entire workforce in 2006, the highest percentage among the 30 members of the Organization for Economic Cooperation and Development (OECD), making Asia's fourth-largest economy extremely vulnerable to outside shocks as small independent businesses are more severely affected by economic downturns than salaried workers. The number of self-employed decreased to 24.1 percent at the end of September this year.

¶5. (SBU) Assembly Budget Office Foresees 3.8 Percent Growth: The National Assembly Budget Office (NABO), the Korean equivalent of the U.S. Congressional Budget Office, stated in its 2010 economic forecast report that the Korean economy will grow 3.8 percent in
¶2010. The economic growth will be high in the first half, affected

by global stimulus packages, but will weaken for the rest of the year due to anticipated implementation of exit strategies and the strengthening won. The NABO also forecasted the number of employed people to increase by 145,000, or 0.7 percent, in 2010 following a 135,000 decline in 2009. Consumer prices are expected to increase 2.5 percent next year, slightly lower than the 2.8 percent rise in
¶2009.

¶6. (SBU) ADB Becomes More Optimistic about the Korean Economy: The Asian Development Bank (ADB) raised its forecast on Korea's GDP growth for 2009 to -2.0 percent from -3.0 percent, while maintaining its 2010 forecast at 4.0 percent. The ADB added that signs of recovery are not strong enough for Asian governments to unwind their expansionary fiscal policies. (NOTE: ROKG agencies are now signaling that 2009 GDP growth may be positive.)

¶7. (SBU) Survey of Economists: Modest Economic Recovery in 2010: According to a survey by the Federation of Korean Industries (FKI) of 21 executive economists at private and state-run research institutes, Korea's GDP growth is expected to fall by 0.7 percent in 2009 by grow by 3.8 percent in 2010. The forecasts were up 1.7 and 1.5 percentage points, respectively, from the survey in May. The more positive forecasts were driven by government measures and foreign exchange rates rather than by improvements in fundamental economic factors. Just over 57 percent answered it would be appropriate to implement an exit strategy in the first half of next year.

¶8. (SBU) ROKG Plans to Increase National Tax Revenues for 2013: In order to increase fiscal soundness, the Ministry of Strategy and Finance (MOSF) aims to collect 219.5 trillion won (USD 187.6 billion) in 2013 tax revenues, rising 54.5 trillion won (USD 46.6 billion) or 33 percent, compared to 2009. In 2010, tax burden per capita is expected to rise by 190,000 won (USD 162) or 4.4 percent from 2009 to reach 4.53 million won (USD 3,872), a record high. The increase will be driven by higher corporate tax and value-added tax revenues reflecting economic recovery in the future. However, revenues from comprehensive real estate taxes and composite income taxes are forecast to continue declining in 2010.

¶9. (SBU) ROKG to Create 650,000 Jobs in 2010: In an emergency economic measures meeting chaired by President Lee Myung-bak on October 15th, the government adopted plans to create about 650,000 jobs in 2010. As a part of the plan, major job creation measures

that are scheduled to end in 2009 will also be extended until the first half of next year. The plan must be approved by the National Assembly as part of the 2010 budget. In addition, a foundation to create jobs will be established through an easing of regulations for new start-ups in the education, medical and tourism industries. The government will also take steps to improve the business environment for people starting small- and medium-sized enterprises.

¶10. (SBU) Overseas Construction Orders Increased in the Third Quarter: The Ministry of Knowledge Economy (MKE) reported that Korean construction and engineering firms received orders to build overseas plants worth USD 16.03 billion in the third quarter, up 6.2 percent from USD 15.09 billion a year earlier. In a clear sign of recovery, bidding on massive construction projects in the Middle East and Africa resumed amid rising oil prices and an improving global economy. MKE anticipated the overseas plant orders would reach USD 16.5 billion in the fourth quarter. Orders in the first half, however, tumbled 67.3 percent to USD 6.7 billion from the previous year.

Finance and Structural Policies

¶11. (SBU) Central Bank Holds the Benchmark Interest Rate at 2 Percent: The Monetary Policy Committee of the Bank of Korea (BOK) decided to hold the benchmark interest rate at 2.0 percent for the eighth straight month. The rate was 5.25 percent in October 2008. BOK Governor Lee Seong-tae clarified that the central bank is prepared to remove the expansionary policy quickly in case of inflationary pressure.

¶12. (SBU) Issuance of FX Bonds Suspended: The government has ceased issuing currency stabilization bonds for the foreseeable future to

limit the fresh inflow of dollars and reduce upward pressure on the local currency. Since the easing of the worldwide credit squeeze in April, local banks and public firms have brought massive amounts of dollars into the country. Along with the active foreign buying of local stocks and bonds, and a strong current account surplus, the government has created a surplus of dollars and undercut the won-dollar rate. According to the MOSF on October 9, the ROKG will review the decision. The ROKG sold sovereign bonds worth USD 3 billion in April, and planned to sell an additional USD 3 billion in bonds in the second half of the year.

¶13. (SBU) FDI Continues to Grow in the Third Quarter: The MKE announced that inbound foreign direct investment (FDI) totaled USD 3.38 billion in the third quarter, up 17.4 percent from a year earlier, continuing to increase after soaring 61.9 percent in the second quarter. Accordingly, accumulated inbound FDI reached USD 8.02 billion for the year up to September, rising 8.1 percent from a year ago. Notably, FDI from Japan surged 161.9 percent, mainly affected by a strengthening yen, and FDI from the EU also ballooned 47.2 percent, swinging back to a rise in the third quarter. In contrast, FDI from the United States slid 44.5 percent.

¶14. (SBU) FSS Toughens Rules on Non-Bank Mortgages: The Financial Supervisory Service (FSS) announced that non-bank lenders such as insurance companies, mutual financing companies and savings banks will, like banks, also be subject to debt-to-income (DTI) regulation on mortgages effective October 12. The DTI regulation was adopted during the previous Administration to curb real estate speculation. This put a ceiling on the size of a mortgage people can get based on their income. Those who seek to buy a home in Seoul, for example, would be subject to a 50 percent DTI rule, while those buying homes in Incheon and Gyeonggi Province would face between 60 and 65 percent ratios. The FSS also bolstered the loan-to-value (LTV) regulation. Currently, one is allowed to obtain a mortgage equal to up to 60 percent of home value from insurers, and up to 70 percent of the value from other financial services firms. Each will see the LTV ratio drop by 10 percentage points. The measure came as people turned to non-bank lenders to get mortgages following the strengthening of DTI regulation on banks.

¶15. (SBU) Foreign Investment in Domestic Bonds Tops USD 42 Billion: According to the FSS, domestic bonds held by foreign investors totaled 48.9 trillion won (USD 41.8 billion) at the end of September, up 11.4 trillion won (USD 9.7 billion) since the beginning of the year. Even though 22.5 trillion won (USD 19.2 billion) in bonds held by foreigners was redeemed during the period, foreign investment in domestic bonds reached its highest level since August 2008. In particular, thanks to steady net purchasing by Thai investors, Asian investment in domestic bonds accounted for the largest portion at 46.2 percent, or 22.6 trillion won (USD 19.3 billion).

¶16. (SBU) Domestic Banks Increase Loan Provisions to 133.6 Percent: According to the FSS, domestic banks' ratio of financing to lending (with maturities of no less than one year for both financing and loans) was 133.6 percent at the end of July, up 28 percentage points from the end of 2008. In 2009 (until the end of July), foreign currency loans from banks with maturities of a year or longer shrank USD 9.87 billion but borrowings with the same maturity increased USD 9.17 billion.

¶17. (SBU) KRX to Open Nighttime Trading of KOSPI200 Futures on CMF Globex: The Korea Exchange plans to launch nighttime trading of KOSPI200 futures after the closing of regular session starting from November 16, 2009. The move has already been approved by the Financial Regulatory Authority. The trading hours of nighttime session of KOSPI200 futures, which has been launched in collaboration with the Chicago Mercantile Exchange, are from 18:00 to 05:00. Investors who wish to participate in the nighttime trading need to open a futures trading account (the existing futures trading account may be used) and enter into a service agreement for nighttime trading. To promote investor awareness, the Korea Exchange is organizing mock trading sessions and road shows on the trading rules and regulations -- how and when to utilize, and how to use the dedicated home trading system (HTS). On September 24th, FSC approved the related regulation on nighttime trading of the KOSPI200 futures.

¶18. (SBU) Currency Swap Line with Japan Extended: South Korea has agreed to extend its currency swap line with Japan by an additional three months in an effort to help stabilize the local financial market, the Bank of Korea (BOK) said on October 16. In mid-December, the BOK agreed with the Bank of Japan to expand its existing won-yen swap facility to USD 20 billion from USD 3 billion. In late March, the two central banks agreed to extend the swap line by six months until October 30. The BOK said that with the latest agreement, the swap facility will be extended until February 1,
¶2010. It also has a won-dollar swap arrangement of USD 10 billion with Japan which can be tapped in the event of an emergency.

¶19. (SBU) NACF Plans to Split Into Bank and Distributor: The National Agricultural Cooperative Federation (NACF), or Nonghyup has announced plans to divide into two entities -- a bank and an agricultural products distributor. According to the restructuring plan, its credit business would separate from the company in 2012 and become a financial holding company with financial affiliates -- bank, securities companies, asset management and futures companies. An agricultural products distribution business would split off as an economic holding company by 2015. Nonghyup's banking business has been profitable, thanks to its monopolistic status in rural areas. This has compensated for losses in its agricultural products distribution business. The division plan, however, goes against the government's plan of spinning both businesses off by 2011. Moreover, it is requesting that the government support the plan by giving 6 trillion won (USD 5.1 billion) for the agricultural products distribution business.

STEPHENS